

I HAVE A FOUNDATION, NOW WHAT DO I DO?

By: Claudia B. Sangster
Director, Philanthropy Services
Harris myCFO, Inc.

The creation of family foundations over the past five years has increased dramatically—over 5,000 foundations were created in 2000 alone, according to The Foundation Center, a New York-based philanthropy research center. The increase in numbers and size is a direct outgrowth of the sudden wealth creation during the stock market boom of the 1990s. The Foundation Center estimates there are over 55,000 private foundations in the United States.

There are many motives for creating a private foundation. Individuals may want to focus their giving on specific causes, to involve their family members and ensure family values are passed down through the years, to turn a family's affluence into influence in the community and to realize certain financial benefits such as tax advantages. Many individuals created their foundations with the expectation that the operation would be similar to their individual giving—simply investing funds and then issuing checks to charities. Experience, however, has taught creators of new private foundations that the process of operation is not as simple as first thought.

COMPLIANCE AND ADMINISTRATIVE MATTERS

The rules governing private foundations are numerous and complex. Founders must carefully wend their way through the private foundation minefield of rules—constant vigilance is key to crossing safely to the other side. For example, many foundations inadvertently run afoul of the self-dealing rules. It is not unusual for foundations to be approached by charitable organizations to buy tickets to gala events. Foundations are more than willing to purchase a table recognizing that the charity will receive a portion of the proceeds because the value of the tickets exceed the costs of the event itself. However, if the Foundation purchases the table and a Founder or other “disqualified person” actually attends the dinner, an act of self-dealing has occurred since a benefit has been received by such individual.

Another example is where a disqualified person wants to sell an asset to the foundation and will do so at a very reduced price. Even if the price is extremely favorable to the foundation, such a transaction constitutes self-dealing under the private foundation rules. These are two of the more commonly violated rules – there are many more.

In addition to complex operational rules, there are other mandates: the foundation must file an annual return (Form 990PF) with the Internal Revenue Service and in some states as well. Each state has its own requirements as to other filings that also must be followed.

Each year, the IRS requires a private grantmaking foundation to distribute a minimum of 5 percent of the value of its investment assets. Foundations that fail to make the requisite distribution are penalized. Each year the foundation must pay an excise tax of 2 percent (in certain special circumstances the tax is 1 percent) on the foundation's income to the federal government. The IRS uses excise tax revenue to police the operations of private foundations.

In order for the foundation to have the resources to make grants, the board of directors needs to think strategically about setting investment policies to meet both operational and grant-making needs. Because the funds are public funds, not only is good stewardship of the foundation's resources essential to the success of the foundation, it is a fiduciary duty to manage the funds as a prudent investor would do.

All of the foregoing rules and mandates highlight that someone needs to be pay attention to the day-to-day operations of the foundation in order to stay in compliance with federal, state and local laws. Not all founders are fully aware of these issues when setting up their foundation, and even if they were, the complexity sometimes results in short-term memory lapses!

GRANT MAKING AND GIFT DISTRIBUTION

The sheer volume of grant appeals received by their family foundations surprises many founders. There is always a great need for funds and foundations are more easily identified now with the advent of the Internet. Fund seekers will find potential funders. Foundations should establish a mission statement or provide concise giving guidelines to avoid wading through appeals which have no chance of gaining support but which must be processed. This wastes both the foundation's and fund seeking organization's time and resources and can create sufficient frustration to rob the founder of the very joy of giving. Certainly, foundations can decide to reject any unsolicited appeals—and some do—but such a position can also result in missed opportunities for projects that would fit perfectly into the family's giving strategy.

Once appeals are selected for further review, the work of the foundation then progresses to the evaluation stage. Researching the funding proposal's project assumptions, financials, the need for the project and potential outcomes requires time. Foundations then must decide the amount of funding to be provided.

Even after the decision has been made to fund a project, the work of the foundation does not end. Verification of the use of the foundation's funds and measuring the project's outcomes – both good and bad – provides a learning opportunity for the foundation and the grantee. Non-profits have historically been the innovators of change and adding to the collective knowledge in the non-profit world as to what works and what does not is still a successful outcome.

FAMILY INVOLVEMENT AND SUCCESSION

One of the most satisfying aspects of establishing a family foundation is the opportunity to bring the family into the giving process. The family foundation provides an excellent platform for educating the next generation in the art of giving and wealth management as well as a place to discuss critical family values in a neutral environment. Working together to decide which nonprofit organizations to support gives each family member a voice in the decision-making process. It is generally years before children feel they can participate in the family decisions. Creating junior boards or appointing next generation members to undertake committee work within the family foundation can allow children or grandchildren the opportunity to share in decision making at an early age. Site visits by the family promote compassion and empathy as family members are brought face-to-face with the reality of the many needs in the community. Analyzing grant appeals and investment reports can also help the next generation learn analytical skills needed to manage their own wealth.

Unlike individuals whose giving ends at death, the foundation generally will survive the founder's death, although some founders do require a "sunset" of their foundations upon their death. If the founder's intent is to continue the foundation into future generations, it is imperative that time be spent developing the next generation of leaders prepared for charitable giving with expertise in the operation of the charity. A well thought out succession plan is the means by which founders can insure the continuity of the foundation after the founder's lifetime.

ASSESSING THE EFFECTIVENESS OF THE FAMILY FOUNDATION

It is never too late to review the processes and procedures of the family foundation to ensure its effectiveness can be realized both now and in the future. Periodic assessment of the foundation's mission statement, giving guidelines, investment policies, grant-making processes and compliance procedures can provide assurance that the foundation is still the best vehicle for the family's philanthropy.

CONCLUSION

The foundation is not a static entity—it should always be evolving as operational learning progresses. The foundation should not merely be the housing for checkbook giving, although many individuals find themselves using their foundations in just such manner. Translating the family's values into action through the family foundation is certainly a laudable goal, but it does not happen by accident. To make the operation of the foundation a satisfying experience as well as a fulfilling legacy, care and attention must be given to its management. Reassessment is a healthy means of assuring that satisfaction and legacy.